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Cc:

Subject: RE: Penalty Computation Question

[REDACTED]

In calculating the penalty the first step is determining the amount of the underpayment. Treas. Reg. § 1.6664-2. The underpayment measures the difference between the amount of tax actually shown on the return filed by the taxpayer (as defined in section 1.6664-2(c)) and the actual amount of income tax imposed after all adjustments are made (as defined in section 1.6664-2(b)). In determining the correct amount of tax imposed credits are generally considered. Any exceptions to this general rule are specifically noted in the calculation regulations. Once an underpayment is concerned the penalty is applied to only the portion of the underpayment attributable to the penalty. Amounts attributable to non-penalty adjustments (which may include credits) are subtracted out according to the ordering rules of Treas. Reg. § 1.6664-3. Several examples help illustrate how this process takes place. Thus, in the case of a general business credit adjustment for which the penalty does not apply, the underpayment attributable to this adjustment is removed before the penalty is applied. Generally an over assessment should not be accounted for separately as it should not enter the determination of the underpayment calculation. Please let me know if you have any additional questions.

I will be out of the office the rest of this week. I will be back in the office all of next week. Please call me when you have a chance, I would like to discuss this with you and make sure that we are on the same page and I have answered your questions.